# United Fire Group Inc.

## Q2 2020 Results Conference Call

## August 5, 2020 at 10:00 a.m. Eastern

**CORPORATE PARTICIPANTS**

**Randy Patten** – *Assistant Vice President & Controller*

**Randy Ramlo** – *Chief Executive Officer*

**Mike Wilkins** – *Chief Operating Officer*

**Dawn Jaffray** – *Chief Financial Officer*

**Bob Cataldo** – *Chief Investment Officer*

**PRESENTATION**

**Operator**
Good morning. My name is Grant and I'll be your conference operator for today. At this time, I would like to welcome everyone to the UFG Insurance Second Quarter 2020 Financial Results Conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press the star then one on your touchtone phone. To withdraw your question, please press the star then two. Please note that this event is being recorded.

I will now turn the call over to Randy Patten, Assistant Vice President and Controller.

**Randy Patten**
Good morning, everyone. Thank you for joining this call. Earlier today we issued a news release on our results. To find a copy of this document, please visit our website at ufginsurance.com. The press release and slides are located under the Investor Relations tab.

Our speakers today are Chief Executive Officer Randy Ramlo; Mike Wilkins, Chief Operating Officer; and Dawn Jaffray, Chief Financial Officer.

Please note that our presentation today may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not a guarantee of future performance. These forward-looking statements are based on management's current expectations. The actual results may differ materially due to a variety of factors which are described in our press release and SEC filings.

Please also note that in our discussion today we may use some non-GAAP financial measures. Reconciliations of these measures to the most comparable GAAP measures are also available in our press release and SEC filings.

At this time, I'm pleased to present Mr. Randy Ramlo, CEO of UFG Insurance.

**Randy Ramlo**
Thanks, Randy. Good morning, everyone. Welcome to our Second Quarter 2020 Conference call.

First, to our employees, agents, policyholders and shareholders, we hope everyone is safe and healthy during this ongoing pandemic. I continue to be amazed by the extraordinary work being completed by our employees during this time, delivering our outstanding service to agents and policyholders without interruption while working remotely. These efforts are truly remarkable considering the higher than normal catastrophe losses we experienced in the second quarter of this year.

As we mentioned in the last call, we had a preexisting business continuity pandemic plan already in place prior to this year. Thanks to our past experience in personally dealing with catastrophes, including the floods of 2008 and 2016 at our corporate headquarters, we were well-prepared and had the technological infrastructure in place for a seamless transition to work from home. This plan was activated in mid-March and continues to be followed on a daily basis.

While our essential services employees have remained in our offices as necessary, the majority of our employees continue to work remotely. We have had ongoing discussions on a return to office plan for our employees but no definitive dates have been set yet. Of course, the safety, health and well-being of our employees will be the top priority of our return to the office plan when it is finalized.

Also, as we mentioned during the first quarter call and as a reminder, nearly all of the policies we have issued contain contract language which specifically excludes business interruption, coverage losses attributable to viruses such as the COVID-19 pandemic. At this time, we expect the effect of COVID-19 on claims currently under our coverages to be manageable. However, the impact of the COVID-19 pandemic continues to evolve and we cannot predict how future legislation, regulation or court actions will impact us.

Although we are still in the midst of the pandemic and it is early in the litigation process, a bit of good industry news emerged from two recent court decisions – one in New York and one in Michigan. In these decisions, the courts upheld the physical damage requirement with business interruption coverage. This is a promising sign that contract law will be upheld in the courts.

Through the first half of 2020, the COVID-19 pandemic did not have as much of an impact on our core insurance operations as we expected. A large portion of our book of business is with contractors who have not been impacted as significantly as many other types of businesses. The one percent decrease in net premiums earned in the first half of 2020 as compared to the first half of 2019 is primarily due to our focus on improving profitability through non-renewal of underperforming accounts in our commercial auto line of business. There was some impact to net premiums earned related to the current economic environment, but it was less significant than the impact from our commercial auto profitability initiatives in the first half of 2020. We anticipate some additional pressure on premiums in the second half of the year as we expect some decrease in new business submission and net endorsement premiums on some business that have reduced payrolls, sales and other exposure units.

In addition, we anticipate premium growth will taper off in the latter part of 2020 due to a combination of underwriting and business factors. We estimated overall reduction in net premiums earned in the range of 6% to 8% in the second half of 2020.

Overall, we believe uncertainty remains surrounding the overall economic impact of the COVID-19 pandemic. Although there was a moderate recovery in the financial markets this quarter, the impact on the economy as a whole may not be felt for some time. Unemployment continues to remain historically high levels and the number of businesses are not operating at full capacity or have closed their doors. These factors may contribute to future pressure on premiums and the demand for our products, which could impact our financial condition and results of operations.

Before turning the call over to Mike to discuss our operational results, I'll briefly comment on our quarterly results. The themes this quarter were historically high quarterly catastrophe losses, improving core insurance profitability, and as I just discussed manageable impact from the COVID-19 pandemic through June 30, 2020.

As we previously announced on July 29, 2020, the largest impact on our financial results during the second quarter of 2020 was catastrophe losses. In the second quarter of 2020, we reported $50.6 million of catastrophe losses or 19.2 percentage points of the combined ratio compared to $22 million or 8 percentage points in the second quarter of 2019. Our historical average for catastrophe losses in the second quarter is 12.2 percentage points. The second quarter of 2020 marks the highest quarterly impact on the combined ratio since the second quarter of 2011 when we experienced losses from a

tornado in Joplin, Missouri. This one out of every ten years quarter included 20 catastrophic events primarily in the Midwest and Southern United States. The majority of losses came from 7 of the 20 events with the largest being a hailstorm near our home office in Cedar Rapids, Iowa. Included in our catastrophe losses this quarter is also $4 million in losses from the riots and civil unrest in Minneapolis, Minnesota where we incurred two large fire losses.

As for our operational results, I'm pleased with the progress in improving the profitability of our book through our underwriting actions and use of analytical tools, despite the challenges we faced with the COVID-19 pandemic. In the second quarter of 2020, we reported a 10.2 improvement in our commercial auto loss ratio. We also had an 11.9 improvement in general liability and a 9 point improvement in our Worker's Compensation lines of business. Improvement in these lines of business contributed to a 5.8 point improvement in our core loss ratio, which excludes CATs and prior accident year reserve development.

Mike will now discuss the improvement in more detail. Mike.

**Mike Wilkins**
Thanks, Randy. Good morning, everyone. As Randy mentioned, we continue to make progress with improving the profitability of our commercial auto book of business in 2020. In the second quarter of 2020, we again saw a decline in the frequency of commercial auto claims. Since June of 2019, commercial auto frequency is down 8%. Additionally, our 12 month moving average of insured commercial auto units has declined 14% since June of 2019.

Slides 7 and 8 in the slide deck on our website present these declines. Although the COVID-19 pandemic may have contributed to some of this decline, it is important to note that the decline in both frequency and number of insured units began well before the pandemic and is primarily the result of our deliberate strategic actions. Also, another important point is that frequency of claims continued to decline in the second quarter even when miles driven increased during the months of May and June of 2020.

The reduction in commercial auto claims frequency and number of commercial auto exposure units, along with favorable prior accident year development, resulted in an improvement of 10.2 points in our commercial auto loss ratio during the second quarter of 2020 as compared to the second quarter of 2019. Year to date the improvement in our commercial auto loss ratio was 10 points. We also experienced an 11.9 improvement in our other liability line of business and a 9 point improvement in Worker's Compensation during the second quarter of 2020. We are very pleased with these results.

As we take steps to return our commercial auto line of business to profitability, we acknowledge that we stand to lose entire accounts since we have traditionally been a package writer. For the third consecutive quarter we experienced a decrease in both policy and premium retention as we focus on non-renewing, underperforming commercial auto accounts, and continue to seek rate increases.

The average renewal pricing change for commercial lines increased 6.6% in the second quarter of 2020 compared to a 7.6% increase in the first quarter of 2020. The renewal pricing increases were driven by commercial auto and commercial property rate increases.

During the second quarter of 2020, the commercial auto effective rate change increased by 12.4% compared to an 11.6% increase in the first quarter of 2020. Also, during the second quarter of 2020, the commercial property effective rate change increased 7.3% compared to a 5.9% increase in the first quarter of 2020. Personal lines renewal pricing increases remained in the mid-single digits.

I will wrap up my portion of today's call by discussing a couple additional strategic decisions we made during the second quarter to improve profitability. First, in May we entered into a personal lines renewal rates agreement with Nationwide Mutual Insurance Company. This agreement was completed as part of our long-term strategic planning allowing us to concentrate our efforts on growth and profitability of our core commercial lines business, including commercial insurance, excess and surplus lines insurance, and surety bonds. Our commercial lines represent 94% of our business mix. UFG's entry into this agreement was purely strategic and was not initiated as a result of market conditions from the COVID-19 pandemic. This agreement provides our independent agents the opportunity to transfer their personal lines policies to Nationwide Mutual Insurance Company beginning in the third quarter of 2020 subject to the receipt of applicable regulatory approvals.

As part of this agreement, Nationwide will offer contracts to almost all of our personal lines agents across the country with the exception of agents in Louisiana. A decision related to our personal lines business in Louisiana will be made at a later date.

Also, during the second quarter, we named Jeremy Ball as our Chief Underwriting Officer. In this new rule, Jeremy will lead the Corporate Underwriting Department and focus on implementation of our underwriting strategic initiatives. Jeremy's first priority will be to drive the implementation of the UFG way of underwriting promoting consistency across the enterprise, portfolio Steering, quality assurance and staff development.

Finally, we continue to make progress with the development of our analytical models. We anticipate that our bot analytics model will be introduction for use in the third quarter of this year and our Worker's Compensation model will be in production in the fourth quarter.

With that, I'll turn it over the discussion to Dawn Jaffray. Dawn.

**Dawn Jaffray**
Thanks, Mike. Good morning, everyone. In the second quarter of 2020, we reported consolidated net income of $6 million compared to a net loss of $4.2 million in the same period for 2019. Year to date, we reported a consolidated net loss of $66.6 million compared with net income of $40.3 million in the same period of 2019. The increase in the fair value of our investments and equity securities, or what I like to refer to as phantom gains of $29.8 million, along with an improvement in the profitability of our core commercial auto and liability business contributed positively to the net income reported in the second quarter of 2020. These positives were offset by the historically high quarterly level of catastrophe losses, some realized investment losses and a decrease in premiums earned from our continued efforts to improve the profitability of our commercial auto business through non-renewing underperforming accounts.

Operationally, we reported an adjusted operating loss of $6.5 million or $0.26 per share in the second quarter of 2020, compared with an adjusted operating loss of $14.9 million or $0.59 per share in the same period of 2019. Also, a one-time pretax benefit of $5.7 million in our second quarter of 2020 was attributable to the renewal rights agreement from our personal lines business with Nationwide.

Year to date, we reported an adjusted operating loss of $5.2 million or $0.21 per share compared with an adjusted operating income of $8.5 million or $0.33 per share in the same period of 2019. Net investment income decreased 10% in the second quarter of 2020, primarily the results of a decrease in invested assets.

Year to date, net investment income declined 51% and narrowly due to the change in the value of our limited liability partnerships. Or, what we refer to as our Bank Funds.

A couple of additional items to note with our investment portfolio, our equity portfolio remains in an unrealized gain position of $144 million as of June 30, 2020. And, we recognized an after tax unrealized gain of $32 million in our bond portfolio during the first six months of 2020.

In addition, we recognize pretax realized investment losses of $14 million on a GAAP basis. These realized losses were primarily from the sale of equity securities. We had a gain as measured against our actual cost basis for these securities. We saw an opportunity to reduce future volatility in our equity portfolio from certain holdings and use offsetting tax losses.

Moving on to operating metrics, the combined ratio in the second quarter of 2020 was 111.4%, improving slightly compared to 111.7% in the second quarter of 2019. Year to date, the combined ratio was 108.2% compared to 103.9% in the same period in 2019. Slide 10 in our presentation on our website contains a reconciliation of components of our reported to adjusted combined ratio.

Our core loss ratio, which removes the impact of catastrophe losses and prior accident year reserve development, improved by 5.8 points in the quarter, primarily due to improved profitability in our commercial auto, other liabilities and Worker's Compensation lines of business, as Mike has mentioned.

We recognized a prior accident year favorable reserve development of $10 million and $23.8 million in the second quarter and year to date 2020 respectively, compared to unfavorable prior accident year reserve development of $9.4 million and $4.7 million in the second quarter and year to date 2019. The prior year favorable reserve development in 2020 was primarily from our commercial property and Worker's Compensation lines of business. Our total reserve position remains within actuarial estimates.

The expense ratio increased 1.5 points in the second quarter and 2.1 points year to date in 2020 as compared to the same periods in 2019. The increase in the expense ratio during the second quarter as compared to prior year's second quarter is primarily due to our continued investment in technologies, including our multiyear Oasis project, which is an upgrade to our underwriting technology platform.

Year to date the aforementioned increased the technology costs along with the acceleration of the amortization of our deferred acquisition costs in our commercial auto line of business added to the increase in the expense ratio. The latter of which added about a point to the expense ratio.

I will now end my portion of the call discussing capital matters and cash flow. As of June 30, 2020, our year to date cash flow remains positive. Our capital position, including having zero debt in our structure, remains strong. As of June 30, 2020, we had $146 million in cash and equivalents compared to $121 million at December 31, 2019.

We continue to look for opportunistic investments to drive investment income as maturities arise. As many in the industry have done, we have implemented payment leniency programs for some of our policyholders as a result of the COVID-19 pandemic. As of June 30, 2020, we did not see a significant impact to premium cash inflows or an increase in our allowance for doubtful accounts as a result of these programs. Our canceled, lapse and non-renewed accounts, of which the majority of non-renewed accounts were UFG initiative driven, represented an increase of only 5% year-over-year; however, uncertainty remains with the pandemic.

The impact of winding down of deferred cancellations, both state mandated and UFG provided leniency, and the corresponding collectability of any premiums or requirements to return premiums in

future periods is yet to be determined. And, future impacts on a financial market, the investment portfolio and demand for our products could impact our results. At this time, we have no intention to draw funds from our credit agreement, but it is available in the event the need arises.

We maintained our current level of cash dividends during the second quarter. During the quarter, we declared and paid a $0.33 per share cash dividend to shareholders of record as of June 5, 2020. Of note, this marks our 209th consecutive quarter of consistently paying dividends.

Lastly, during the quarter we did not repurchase any UFG shares. We made the decision in mid-March to suspend share repurchases in the interim. As a reminder, we had repurchased just over 70,000 shares for $2.7 million on a year to date basis. We remain authorized by our board of directors to purchase an additional 1.8 million shares of common stock under our share repurchase program, which will expire at the end of this month unless it is extended by the board.

And with the closing of our prepared remarks, I will now open the line for questions. Operator.

**QUESTIONS AND ANSWERS**

**Operator**
Speakers, your line is now live. We will now begin the question and answer session. To ask a question, you may press the star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press the star then two. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Marla Backer with Sidoti.

**Marla Becker**
Thank you. So just a couple of questions to clarify some of the items. We've been hearing from other insurers and reading about is that the frequency of auto collisions declined during this pandemic, but the severity climbed in many markets, so that doesn't seem to be what you are seeing. Is that the way to read that?

**Randy Ramlo**
We've actually experienced the exact same thing. I think we mentioned that we're pretty heavily in the construction area, so that line of business kind of continued through most of the pandemic. Our frequencies were down pretty considerably, but we didn't have any break in the severity of losses. So, it seems like the people that were out driving around on empty roads must have been driving faster. But we have experienced kind of the exact same thing.

**Marla Backer**
Okay. And on the Nationwide agreement, can you just provide a little bit more color there? Why was the agreement structured to exclude that one state? Was it specific to Nationwide because they don't write policies there or what was the reason for the way it was structured to exclude Louisiana?

**Randy Ramlo**
That's exactly it. I think Nationwide writes in 49 states and Louisiana is the one that they don't, so we'll get that figured out going forward.

We're having pretty good success. The non-renewals kind of start, starting 10/1. We have commitments from high 80% of agents to go with the Nationwide deal, so not much more to comment

other than we think it's going pretty well. We have to get approval from all the states. We've had good progress there, but we're not completely done with that process yet.

Mike, do you have anything to add?

**Mike Wilkins**
No, I think you hit all the high points there, Randy. I think we have three states remaining that we don't have approval from yet. I think two of those are pretty close. So good progress. We are no longer writing new business in the personal lines segment, so we are seeing the production already starting to decline even in the second quarter a little bit.

**Marla Backer**
Okay. Then last question, so that's great news about the business interruption clauses being tested and being supported in those cases in those two states that you mentioned. Is there anything else that we should think about in terms of possibly testing the policies because of COVID? Anything because of the riots that have occurred in many markets? Or is there anything else that we should be thinking about that might arise because of COVID that is on the horizon.

**Randy Ramlo**
I'm a long ways from an expert on this. I think the biggest thing going forward is the possibility of kind of more shutdowns, which could cause more businesses going out of business, more bankruptcies, the shrinkage of kind of the insurance industry due to that and who knows where that's going to go. Riots and civil unrest are a covered peril, so if the riots continue, which they've been quieting down a little bit, if they do continue those are covered, but I don't see as being a gigantic part of the industry in general.

Legislatively, regulatory things have been pretty good. There's a big question on how is Worker's Compensation going to respond to this. I think California has had some negative rumblings, I guess you might say. We don't write any Worker's Compensation in California. Obviously, we don't do any med mal or any of that stuff, so for us I don't think it's going to be a large factor, but we really keep watching on individual states, individual court cases that could go south. So, keeping track of it, but I'd be lying if I said I knew all the answers.

**Marla Backer**
Thank you very much.

**Randy Ramlo**
Thank you.

**Operator**
Our next question will come from Paul Newsome with Piper Sandler. Please go ahead.

**Paul Newsome**
Good morning. Hopefully everyone's healthy and safe. I wanted to ask you a little bit more about the premium reduction comments that you made for the second half. I think I recall, if you said it correctly, that you're looking at a decline of 6% to 8%. Does that include the runoff of the personalized business in there as well or is it just the commercial lines that we're talking about?

**Mike Wilkins**
Hi Paul, this is Mike, I'll try to take that one. Yes, that does include the personal lines runoff in the calculation as we tried to make an estimate for the second half.

A couple other things that we think will probably impact the second half written premium. One is our specialty division. They have had really nice growth in the first half. We think growth will continue in the second half, but we don't think the percentage increase will be quite as large for various reasons. And because of that, we think we won't get quite as much contribution from that unit.

We also have a program with Arrowhead writing some earthquake business in California that we've kind of reached our capacity on. So again, in the second half we think we'll see a little bit of growth from rate increases in that segment, but we aren't expecting the contribution from that in the second half that we saw in the first half. So, those things combined, we are a little bit more pessimistic about the top line in the second half.

**Paul Newsome**
Makes sense. Then relatedly, could you talk about sort of the outlook for the expense ratio? I assume that I would expect that we'd see some pressure there because of the declining premium, but obviously there's some offsets here while you're shutting down your personalized business. Could you help me with that?

**Dawn Jaffray**
Sure. Hi, Paul. This is Dawn. So, I think a couple of things. You're correct, with the decline in premium that is certainly going to make an impact to our numbers. We also, as I had mentioned, continue to have a little bit of the DAC issue, the inability to defer on the commercial auto because the loss ratio is still not where it needs to be for the very formulaic calculation we're required to undertake.

I think during the third quarter it will be interesting to see the portion of payments that had been deferred for calculation that we have not been able to cancel due to state mandates, what the impact of that will be. Currently how that works is the payments get deferred and then get billed out, spread out over the remaining term. Then we continue to make investments in technology as a number of companies are doing. So, realistically, probably in that sort of between 33.5 maybe to 34, depending on the nature of the circumstances with the decline in premium.

**Paul Newsome**
Is it fair to say that this is probably, both of these issues, the premium and the expensing would probably be something you'd be talking about, the first half of next year given that at least I would imagine the personal lines will take that long to run off as well. Just thinking a little bit further than maybe just the second half.

**Dawn Jaffray**
It will depend. As you know, and as Mike and Randy have both indicated, Paul, we've also taken on a considerable amount of deliberate non-renewals. So clearly, we are looking at every element of our expenses. The commissions and salaries are the two biggest components of our expense ratio, so we have to pay attention to both of those.

We have looked at a few changes in our commission plans that will start to take effect, but I think it's a little early to say completely what will happen, but with the smaller premium base I would expect there continue to be pressure next year, in the first half of next year. But we're going to look for ways to offset that.

**Paul Newsome**
Was there much resources dedicated just to the personal lines business? At United Fire.

**Randy Ramlo**
I think. This is Randy, Paul, it made up about 6% of our writings and we probably benchmarked a hair high on expenses. That's kind of about that same area. I think there's how many employees, under 20, I think. Not a huge factor, but it was probably something that on an overall cost basis – you know, one of the reasons we did the deal with Nationwide is we found it very difficult to compete as a small personal lines player. Then kind of a grim future a little bit for especially small carriers like us. I don't think that will be a negative or a positive, necessarily, on expenses long-term, but it might be a little drag in the short-term.

**Paul Newsome**
That makes sense. Lots of folks are seeing the same thing, I think.

Then the last thing I was wondering if you could help me with is maybe talking about the components of the invested assets declining. You were talking about that prospectively. I'm looking at the balance sheet, it doesn't look like you've had huge changes in total invested assets as they bump around, but are you in essentially a cash flow negative position at the moment and is that why invested assets are falling or is there some other component there, I'll just let you answer the question

**Bob Cataldo**
Hi, Paul. This is Bob Cataldo. Thanks for the question.

No, we have not initiated any concerted effort to reduce or erase cash in the portfolio. I think what you're seeing is just natural runoff as the businesses contracted slightly. Overall, it would make sense that the assets would follow that trend as well.

We did reduce a little bit on the equity side, as was mentioned earlier by Dawn, but that was again just opportunistic and more of a rebalancing exercise than any reallocation or change in the investment philosophy or policy.

**Paul Newsome**
Great. Thanks, guys. Appreciate it.

**Randy Ramlo**
Thank you, Paul.

**Operator**
Again, if you'd like to ask a question, it's star then one; star then one to ask a question.

**CONCLUSION**

**Operator**
This concludes our question-and-answer session. I would like to turn the conference back over to Randy Patten for any closing remarks. Please go ahead.

**Randy Patten**
This now concludes our conference call. Thank you for joining us and have a great day.

**Operator**
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.